

The Kiddie Tax and Military Survivors' Benefits

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Some military families discovered that they owed higher taxes for 2018 and 2019 on distributions from their military survivors' benefits than they had in previous years. This change in tax treatment was related to temporary changes to the "kiddie tax" in the 2017 tax revision (P.L. 115-97). However, Congress enacted language in the Further Consolidated Appropriations Act, 2020 (P.L. 116-94) that repealed those temporary changes to the kiddie tax beginning in 2020. In addition, P.L. 116-94 enables taxpayers to retroactively elect to be taxed as if the kiddie tax changes in P.L. 115-97 did not apply in 2018 and 2019 (by filing an amended tax return).

Military Survivor Benefits to Children

Retired servicemembers may elect to provide their spouses and/or children with up to 55% of their pension following the member's death as part of a program called the [Survivor Benefit Plan](#) (SBP) (10 U.S.C. 1448). In 2001, as part of P.L. 107-107, Congress expanded eligibility for this benefit to dependents of servicemembers who die while in active service. The Department of Defense (DOD) distributes SBP payments as a taxable monthly annuity for the lifetime of a surviving spouse, former spouse, and/or surviving children up to age 18 or 22. Due to a dollar-for-dollar offset with another federal benefit for some surviving spouses called [Dependency and Indemnity Compensation](#) (DIC), it is often more financially beneficial for families with a member who dies on active duty to elect children as the SBP beneficiaries to avoid this offset. As of September 30, 2018, [DOD reported](#) 2,736 dependent children receiving SBP annuities as the sole beneficiary due to a parent's death in retirement and an additional 7,179 receiving an annuity due to a parent's death during active service. The amount of the SBP annuity

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varies and depends on the servicemember's retired pay base at the time of death. [On average](#), a survivor receives about \$1,050 per month from SBP alone (not including other benefits, such as Social Security).

In Section 622 of the National Defense Authorization Act for FY2020 (NDAA; P.L. 116-92), Congress repealed the SBP-DIC offset with a three-year phaseout period. This law also repealed eligibility for spouses of members who die on active duty to transfer the SBP benefit to a child or children. Spouses who elected to transfer the SBP benefit to their children under prior law will have the ability to have this benefit transferred back to them if they continue to meet other eligibility criteria. The Congressional Budget Office (CBO) [estimated](#) these changes would increase direct spending by \$4.68 billion over 10 years.

What Is the Kiddie Tax?

The [kiddie tax](#) was first enacted as part of the Tax Reform Act of 1986. Its purpose was to prevent wealthy parents from reducing their own tax liability by creating investment accounts and trusts in the names of their children, who would typically be subject to lower tax rates.

Generally, a child must file a separate return to report his or her income (like any other taxpayer). Generally, a child's unearned income above \$2,100 for 2018 (\$2,200 for 2019) [may be subject to the kiddie tax](#). The kiddie tax applies regardless of whether the child may be claimed as a dependent on his or her parents' return.

The parents may elect to include on their return the unearned income of a child to avoid the kiddie tax. If a child's gross income is only from interest and dividends and the amount of the gross income is greater than [\\$1,050 in 2018 \(\\$1,100 for 2019\)](#) and less than [\\$10,500 in 2018 \(\\$11,000 for 2019\)](#), the parents may elect to report the child's gross income on the parents' return, and the child is treated as having no gross income. The election is made by filing [Form 8814](#). A tax of 10% is imposed on up to [\\$1,050 in 2018 \(\\$1,100 for 2019\)](#) of the child's gross income included on the parents' return.

Computation of the Kiddie Tax Before and After the 2017 Tax Revision

Before enactment of the 2017 tax revision (P.L. 115-97), the child's tax liability under the kiddie tax was equal to the greater of (1) the tax on all of the child's income without regard to the kiddie tax or (2) the sum of the tax on the child's total income reduced by net unearned income plus the child's share of the "allocable parent tax." The allocable parent tax equaled the hypothetical increase in tax to the parent that resulted from adding the child's net unearned income to the parent's taxable income. The effect was that the child's unearned income was taxed at the higher of the child's or parent's marginal tax rate.

The 2017 tax revision changed the calculation of the kiddie tax by taxing a child's unearned income according to the [tax rates that apply to estates and trusts](#) rather than through the allocable parent tax method. The graduated rates for income from estates and trusts applied at relatively low income levels, though, compared to ordinary income tax rates. These changes, which increased the rate of tax on a child's unearned income, were in effect under the law for the 2018 and 2019 tax years (and were supposed to be temporarily in effect through 2025). Hence, as a result of this change, some military families owed higher taxes on their military survivors' benefits than they had in previous years.

Legislative Activity

On December 20, 2019, Congress enacted the Further Consolidated Appropriations Act, 2020 (P.L. 116-94). Division O, [Section 501](#) of that law repealed the 2017 tax revision's changes to the kiddie tax beginning with the 2020 tax year. P.L. 116-94 also allows taxpayers to file an amended tax return for the 2018 or 2019 tax years and retroactively elect to be taxed as if the 2017 tax revision's kiddie tax changes did not apply. The Joint Committee on Taxation (JCT) [estimated](#) that the provision would reduce federal

revenue by \$470 million over 10 years.

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